CONNECTICUT VOICES FOR CHILDREN

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Testimony in Support of H.B. 5487, H.B. 5489, and H.B. 5490

Finance, Revenue, and Bonding Committee
March 25, 2022

Dear Senator Fonfara, Representative Scanlon, Senator Martin, Representative Cheeseman, and members of the Finance, Revenue and Bonding Committee:

Connecticut Voices for Children (CT Voices) supports the following three bills:

To offset the unfair property tax burden on working- and middle-class families, **CT Voices supports H.B. 5487**, "An Act Concerning the Property Tax Credit" and **H.B. 5490**, "An Act Establishing a Personal Income Tax Deduction for Rent Paid on a Primary Residence in the State."

To eliminate a built-in, or hidden, annual income tax increase on working- and middle-class families, **CT Voices supports H.B. 5489**, "An Act Concerning the Indexing of Certain Personal Income Tax Thresholds and Exemption Amounts."

Below, we review the reasons for our support, and we also provide recommendations to strengthen the bills.

Offsetting the Unfair Property Tax Burden on Working- and Middle-Class Families

A report we published last month highlights the key finding presented in **Table 1**, Connecticut's unfair tax system continues to exacerbate income inequality and the racial income gap. The report also shows that the property tax is the most unfair component of Connecticut's unfair tax system.[1]

Table 1. The Impact of Connecticut's Unfair—or Regressive—Tax System

Average Family / Median Household	Pre-Tax		Effective	Post-Tax		Change in
	Income	Inequality Ratio	State & Local Tax Rate	Income	Inequality Ratio	Inequality Ratio
Average Wealthy Family	$3,083,600	-	7.08%	$2,865,300	-	-
Average Upper-Class Family	$352,800	**8.7x**	10.35%	$316,300	**9.1x**	**+0.4**
Average Middle-Class Family	$97,400	**31.7x**	15.50%	$82,300	**34.8x**	**+3.1**
Average Working-Class Family	$22,500	**137.0x**	25.96%	$16,700	**171.6x**	**+34.6**
Average Wealthy Family	$3,083,600	-	7.08%	$2,865,300	**-**	-
Median White Household	$85,800	**35.9x**	15.50%	$72,500	**39.5x**	**+3.6**
Median Latino/a/x Household	$49,200	**62.7x**	19.55%	$39,600	**72.4x**	**+9.7**
Median Black Household	$48,900	**63.1x**	19.55%	$39,300	**72.9x**	**+9.8**

*Data from CT DRS, U.S. Census Bureau, and author's calculations. Pre- and post-tax incomes rounded to nearest hundred.

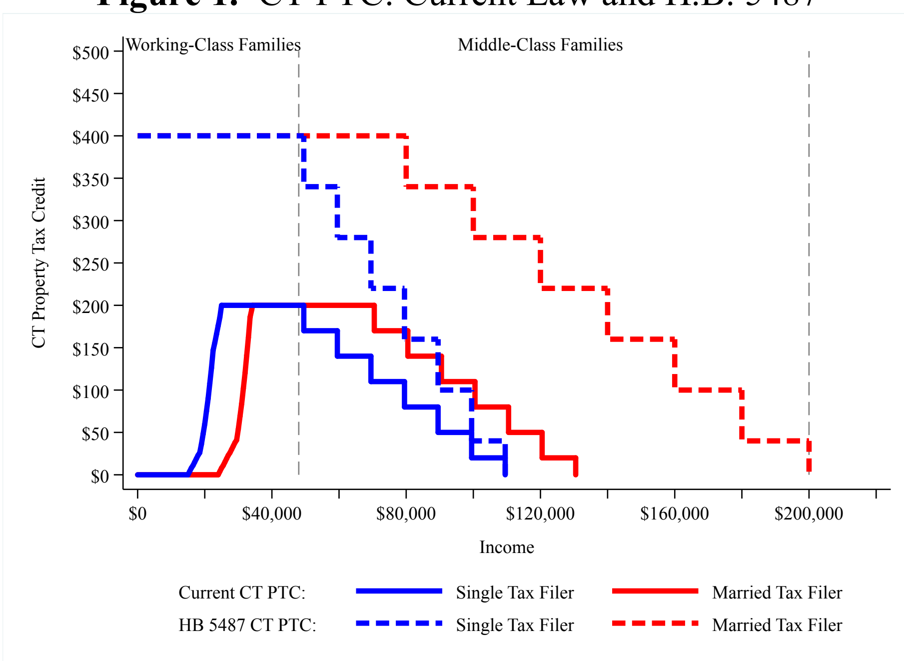
To address Connecticut's historic level of income inequality, substantial racial income gap, and an unfair tax system that exacerbates those problems, CT Voices supports **H.B. 5487**, "An Act Concerning the Property Tax Credit" and **H.B. 5490**, "An Act Establishing a Personal Income Tax Deduction for Rent Paid on a Primary Residence in the State."

H.B. 5487 would (1) increase the maximum amount of the Connecticut property tax credit (CT PTC) from $200 to $400, (2) eliminate restrictions that make the CT PTC only available to seniors or families with a dependent, (3) eliminate the marriage penalty by extending the phase-out for married tax filers, (4) inflation index the parameters of the CT PTC, and (5) make the CT PTC refundable.

Figure 1 provides an overview of the current CT PTC and the proposed changes. The key findings are reviewed below.

Making the CT PTC refundable and increasing the maximum amount of the credit would both help to offset the unfair property tax burden for many working-class families. A "refundable" tax credit is paid to a tax filer if it exceeds their income tax liability, whereas a "nonrefundable" tax credit is capped by the amount of income tax liability. Although many working-class families pay at least $200 in the property tax and meet the necessary income requirements, they do not have enough income tax liability to qualify for the maximum CT PTC and therefore receive either no credit or a reduced credit. For example, a married family that makes $22,500 (the average working-class income) would receive no credit under existing law because the family does not have income tax liability. In contrast, by making the CT PTC refundable and increasing the maximum amount, the average working-class family would receive an income tax cut of $400.

Figure 1. CT PTC: Current Law and H.B. 5487



*Data from CT General Statutes, CT General Assembly, CT DRS, and author's calculations.

Extending the phase-out of the CT PTC for married tax filers and increasing the maximum amount of the credit would both help to offset the unfair property tax burden for many middle-class families. Despite paying at least $200 in the property tax, many middle-class families receive either a reduced CT PTC or no credit due to their income level. For example, a married family that makes $71,000 (a lower-end middle-class income) would receive a maximum credit of $170 under existing law, a married family that makes $97,400 (the average middle-class income) would receive a maximum credit of $110, and a married family that makes $150,000 (a higher-end middle-class income) would receive no credit. In contrast, by extending the phase-out for married tax filers and increasing the maximum amount of the credit, the above lower-end middle-class family would receive an income tax cut of $400, the average middle-class family would receive an income tax cut of $340, and the above higher-end middle-class family would receive an income tax cut of $160.

H.B. 5490 would establish an income tax deduction equal to 50 percent of rent paid, up to a maximum of $5,000, which would help to offset the high property tax burden for working- and middle-class families that are renters and do not qualify for the CT PTC.

Table 2 provides an overview of current law (i.e., no rent deduction) and the proposed change. The key findings and recommendation are reviewed below.

The proposed income tax deduction for rent paid would help to offset the unfair property tax burden for many working- and middle-class families. A married family that makes $22,500 (the average working-class income) would not receive an income tax cut from the proposed income tax deduction for rent paid because the family does not have income tax liability. However, a married family that makes $45,000 (a higher-end working-class income) would receive an income tax cut of up to $145, and a married family that makes $97,400 (the average middle-class income) would receive an income tax cut of up to $233.

Although the proposed income tax deduction would provide support for many working- and middle-class families, it is inferior to making the increased and reformed CT PTC available to renters. Compared to the status quo, the proposed income tax deduction is a substantial improvement because, as demonstrated, it would provide a tax cut for many working- and middle-class families. However, it is inferior to making the increased and reformed CT PTC under H.B. 5487 available to renters for at least two reasons. First, unlike the proposed CT PTC under H.B. 5487, which is refundable and therefore can exceed a tax filer's liability, a tax deduction cannot exceed a tax filer's liability. As a result, working-class families with the lowest incomes will not receive a tax cut. Second, unlike the proposed CT PTC, which decreases as a tax filer's income level increases, the proposed tax deduction would create a tax cut that increases as a tax filer's income level increases because the amount of the tax cut is based in part on the tax filer's marginal tax rate (i.e., top tax rate). For example, when adding a $5,000 deduction for rent to the existing exemption of $24,000, the higher-end working-class family would have a marginal tax rate of 3 percent and would receive a tax cut of $145. In comparison, the average middle-class family would have a marginal tax rate of 5 percent and would receive a tax cut of $233. In general, the impact of a tax deduction is equal to the amount of the deduction multiplied by the marginal tax rate, though in Connecticut the calculation is more complicated due to the design of the personal tax credit, which is based on a percentage of a tax filer's liability.

As currently written, H.B. 5490 includes no income thresholds and therefore would provide a tax cut for some upper-class and wealthy families. If policymakers establish this tax deduction rather than make the increased and reformed CT PTC available to renters, we recommend phasing out the deduction for single filers making more than $100,000 and married filers making more than $200,000. We also recommend inflation indexing the income thresholds and amount of the deduction.

Table 2. Income Tax Cut for Rent Paid: Current Law and H.B. 5490

Income Group	**Average Working-Class Family**		**Higher-End Working-Class Family**		**Average Middle-Class Family**	
Tax Filing Status	Married	Married	Married	Married	Married	Married
Housing Status	Renter	Renter	Renter	Renter	Renter	Renter
Tax Exemption / Deduction						
Pre-Tax Income	$22,500	$22,500	$45,000	$45,000	$97,400	$97,400
Exemption	$24,000	$24,000	$24,000	$24,000	$0	$0
H.B. 5490 Rent Deduction	-	$5,000	-	$5,000	-	$5,000
Total Taxable Income	$0	$0	$21,000	$16,000	$97,400	$92,400
Tax Brackets						
3%: $0 - $20,000	-	-	$600	$480	$600	$600
5%: $20,001 to $100,000	-	-	$50	-	$3,870	$3,620
5.5%: $100,001 to $200,000	-	-	-	-	-	-
6%: $200,001 to $400,000	-	-	-	-	-	-
6.5%: $400,001 to $500,000	-	-	-	-	-	-
6.9%: $500,001 to $1,000,000	-	-	-	-	-	-
6.99%: $1,000,001 and up	-	-	-	-	-	-
3% Tax Phase-Out Add-Back	-	-	-	-	-	-
Tax Recapture	-	-	-	-	-	-
Total Liability Before Credits	$0	$0	$650	$480	$4,470	$4,220
Tax Credits						
Personal Tax Credit	$0	$0	$98	$72	$313	$295
Income Tax Liability						
In Dollars	$0	$0	$553	$408	$4,157	$3,925
Effective Tax Rate	0.0%	0.0%	1.2%	0.9%	4.3%	4.0%
Income Tax Cut for Rent Paid						
In Dollars	-	$0	-	$145	-	$233

*Data from CT General Statutes, CT General Assembly, CT DRS, and author's calculations. Assumes renters do not own motor vehicles and therefore do not qualify for the CT PTC.

Eliminating a Built-In, or Hidden, Annual Income Tax Increase on Working- and Middle-Class Families

To further address Connecticut's historic level of income inequality, substantial racial income gap, and an unfair tax system that exacerbates those problems, CT Voices supports **H.B. 5489**, "An Act Concerning the Indexing of Certain Personal Income Tax Thresholds and Exemption Amounts." As the title indicates, this bill would (1) inflation index Connecticut's personal income tax exemption and (2) inflation index Connecticut's personal income tax brackets.

Table 3 provides an overview of the current impact of Connecticut's income tax on working- and middle-class families and the potential impact if policymakers had initially inflation indexed the key components of the income tax. The key findings and recommendation are reviewed below.

"Tax exemption creep" operates as a built-in, or hidden, annual income tax increase on working- and middle-class families because Connecticut's income tax exemption is not indexed to inflation. Inflation is a decrease in the purchasing power of money due to an increase in the price of goods and services, and "tax exemption creep" is when a tax filer's income increases to keep up with inflation but that nominal increase in income decreases the tax filer's exemption, resulting in a higher income tax liability even though the tax filer's real purchasing power has not increased. To prevent this annual tax increase on working- and middle-class families, the federal government and many states index their exemptions or deductions to inflation, meaning the amount and income thresholds increase each year based on the rate of inflation. Connecticut's income tax exemption, however, is not indexed to inflation and the real value and real income thresholds have decreased considerably over time. For example, when Connecticut established a broad-based income tax in 1991, it included an exemption of $24,000 for married filers making up to $48,000. If the state had indexed the exemption in 1991 to the consumer price index, the maximum exemption in 2021 would be $47,500 for married filers making up to about $95,000. Currently, however, a family making $95,000 has an exemption of $0.[2]

"Tax bracket creep" operates as a built-in, or hidden, annual income tax increase on working- and middle-class families because Connecticut's income tax brackets are not indexed to inflation. Similar to tax exemption creep, "tax bracket creep" is when a tax filer's income increases to keep up with inflation but that nominal increase in income puts the tax filer into higher income tax brackets, resulting in a higher income tax liability even though the tax filer's real purchasing power has not increased. To prevent this annual income tax increase on working- and middle-class families, the federal government and many states index their tax brackets to inflation, meaning the income levels for the tax brackets increase each year based on the rate of inflation. Connecticut's income tax brackets, however, are not indexed to inflation and that has significantly increased the tax burden on many families over time. Consider the five percent tax bracket, which impacts many working- and middle-class families. Since 2003, the tax bracket has applied to taxable income above $20,000 for married filers. If the state had initially indexed the tax bracket to the consumer price index, in 2021 it would only apply to income above about $28,900 for married filers.[3]

"Tax credit creep" operates as a built-in, or hidden, annual income tax increase on working- and middle-class families because Connecticut's personal tax credit is not indexed to inflation. Similar to tax exemption creep and tax bracket creep, "tax credit creep" is when a tax filer's income increases to keep up with inflation but that nominal increase in income decreases their tax credit, resulting in a higher income tax liability even though the tax filer's real purchasing power has not increased. To prevent this annual income tax increase on working- and middle-class families, the federal government and many states index their tax credits to inflation, meaning the amount of the credits and income thresholds increase each year based on the rate of inflation. Connecticut's personal tax credit, however, is not indexed to inflation and that has increased the tax burden on many working- and middle-class families over time. For example, when the state established a broad-based income tax in 1991, it included a personal tax credit that only entirely phased out for married filers making more than $96,000. If the state had indexed the original tax credit to the consumer price index, in 2021 it would not entirely phase out until a married filer makes more than $189,900.[4]

Altogether, tax exemption creep, tax bracket creep, and tax credit creep have generated a nearly $2,400 tax increase on the average middle-class family and an approximately $550 tax increase on a higher-end working-class family, which has offset most of the support that family receives from the Connecticut earned income tax credit (CT EITC). Although the failure to inflation index the key components of Connecticut's income tax currently harms middle-class families the most, it will increasingly harm working-class families, which disproportionately includes families of color. If Connecticut had initially inflation indexed the key components of Connecticut's income tax the income tax burden for the average working-class family would be the same because that family currently has no income tax liability. However, the tax burden would be $553 lower for a higher-end working-class family, and it would be $2,366 lower for the average middle-class family. Two related points are essential to highlight here. First, the inflation-based tax increase for the higher-end working-class family almost entirely offsets the $569 tax cut that family receives from the CT EITC if it has two children. Second, the inflation-based tax increase is currently much greater for the average middle-class family because tax exemption creep has entirely phased out the tax exemption for that family, and tax bracket creep and tax credit creep have both exacerbated that development. Moving forward, this process will increasingly harm working-class families. For example, the higher-end working-class family is quickly approaching the $48,000 income threshold that initiates the phase out of the tax exemption.[5]

Connecticut is an outlier in failing to inflation index any of the key components of its income tax. Of the 41 states with a personal income tax on wage income, only 13 states (or about 32 percent) fail to inflation index any of the key components.[6]

As currently written, H.B. 5489 would inflation index the personal income tax exemption and brackets. We recommend also inflation indexing the personal tax credit. At two percent inflation—the Federal Reserve's long-term target—inflation indexing Connecticut's income tax would cost $46 million a year, and the personal tax credit component would account for $6 million of the total cost.[7]

Table 3. Impact of Connecticut's Income Tax on Working- and Middle-Class Families

Current Income Tax

Income Group	Average Working-Class Family	Higher-End Working-Class Family	Average Middle-Class Family
Tax Filing Status	Married	Married	Married
Number of Children	2	2	2
Tax Exemption			
Pre-Tax Income	$22,500	$45,000	$97,400
Exemption	$24,000	$24,000	$0
Total Taxable Income	$0	$21,000	$97,400
Tax Brackets			
3%: $0 - $20,000	-	$600	$600
5%: $20,001 to $100,000	-	$50	$3,870
5.5%: $100,001 to $200,000	-	-	-
6%: $200,001 to $400,000	-	-	-
6.5%: $400,001 to $500,000	-	-	-
6.9%: $500,001 to $1,000,000	-	-	-
6.99%: $1,000,001 and up	-	-	-
3% Tax Phase-Out Add-Back	-	-	-
Tax Recapture	-	-	-
Total Liability Before Credits	$0	$650	$4,470
Tax Credits			
Personal Tax Credit	$0	$98	$313
Earned Income Tax Credit	$1,824	$569	$0
Total Tax Credits	$1,824	$667	$313
Income Tax Liability			
In Dollars	-$1,824	-$17	$4,157
Effective Tax Rate	-8.1%	-0.04%	4.3%

Income Tax If Key Components Were Initially Indexed To Inflation

Change in Tax Liability			
In Dollars	$0	-$553	-$2,366
Effective Tax Rate	0.0%	-1.2%	-2.4%
Total Income Tax Liability			
In Dollars	-$1,824	-$569	$1,791
Effective Tax Rate	-8.1%	-1.3%	1.8%

*Data from CT DRS, Internal Revenue Service, CT General Assembly, and author's calculations. Numbers may not add up due to rounding.

Thank you for your consideration,

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References

[1] Patrick R. O'Brien. (2022). "Connecticut's 2022 Tax Incidence Report: A High-Level Overview and Comparison to the 2014 Report." Connecticut Voices for Children.

[2] Patrick R. O'Brien. (2022). "Steps to a Fairer Tax System." Connecticut Voices for Children. See pages 29–30.

[3] Patrick R. O'Brien. (2022). "Steps to a Fairer Tax System." Connecticut Voices for Children. See pages 31–32.

[4] Patrick R. O'Brien. (2022). "Steps to a Fairer Tax System." Connecticut Voices for Children. See pages 37–38.

[5] Patrick R. O'Brien. (2022). "Steps to a Fairer Tax System." Connecticut Voices for Children. See pages 47–51.

[6] Jared Walczak. (2021). "As Inflation Rises, So Will Tax Bills in Many States." Tax Foundation.

[7] Patrick R. O'Brien. (2022). "Steps to a Fairer Tax System." Connecticut Voices for Children. See pages 73–74. Cost estimates are provided by the Institute on Taxation and Economic Policy.